STATE OF INDIANA

Indiana Finance Authority
Debt Management Policy for State Appropriation-Backed Debt

Introduction and Summary

Purpose of Policy

In order to meet the capital financing needs of the State of Indiana, the State is authorized to issue debt by various State agencies that are backed by State appropriations and project revenues. The funding of these capital improvements through the issuance of debt by the Indiana Finance Authority makes it fiscally prudent to formalize guiding principles to govern the issuance and sale of State debt.

Proper management of debt is fundamental to sound financial management practices and protecting the financial condition of the State. The State of Indiana and the Authority recognize that the foundation of managing debt is a sound debt management policy. This debt management policy sets forth certain parameters and provides general guidance regarding the following decisions:

1) The purposes for which debt may be issued;
2) Structural features of debt being issued;
3) The types of debt permissible; and
4) Compliance with securities laws, disclosure requirements, and federal tax laws.

The following policies are intended to provide guidance in the structuring and sale of State debt. However, exceptions to the general principles set forth may be appropriate under certain circumstances after careful consideration of the facts of each case, and can be modified at any point in the future. Thus, additional guidelines and policies may be necessary as new State initiatives are implemented or as innovative financial products and debt structures evolve over time.

Scope of Policy

The Indiana Finance Authority's debt management policy applies to all debt or debt related obligations issued by the State Office Building Commission, the Transportation Finance Authority, the Recreational Development Commission, and the State Revolving Fund.

<u>Purposes for Which Debt is Issued</u>

New Money

New money bonds should be issued only to finance capital assets. The use of available cash to fund all or a part of the cost of capital improvements should be explored before proposing the issuance of long-term debt for such purposes. In the event capital assets with anticipated useful lives of less than five years (such as equipment) are being funded, the Authority may also consider utilizing cash or tax exempt leasing to most economically finance these types of assets.

Refundings

Generally, the Authority issues refunding bonds to achieve debt service savings on its outstanding fixed rate bonds by replacing high interest rate callable debt with lower interest rate debt (an "*economic refunding*"). However, refunding bonds may also be issued to restructure debt or modify covenants contained in the bond documents. Overall, refunding bonds should be issued in order to realize present-value savings due to a decline in interest rates or, in certain circumstances, to restructure outstanding debt on terms more favorable to the State.

The Authority can decide to refund callable bonds either on or after their call date ("current refunding") or before their call date ("advance refunding"). According to federal tax law, the State may only issue tax-exempt advance refunding bonds once to refinance bonds issued after 1986. There is no similar limitation for tax-exempt current refunding bonds. Due to the restriction on advance refunding bonds, debt service savings should generally have a minimum target savings level measured on a present value basis versus the par amount of the bonds being advance refunded.

Economic Advance Refunding Criteria: In order to be able to adapt to changing interest rate environments, the Authority must be prepared to issue advance refunding bonds to achieve debt service savings in a timely manner. Thus, the Authority establishes the following advance refunding criteria that must be met to accomplish an economic refunding:

1) Aggregate present value debt service savings must equal at least 3.5% of the par amount of bonds refunded. However, The Authority staff can deviate from this threshold for programmatic issues with approval from the board chairman and director of Public Finance. Still, the Authority's stated objective is to achieve a present value savings level of at least 4.5% of the bonds refunded; and,

2) For each individual maturity of the bonds refunded, each maturity must generate a positive present value savings benefit to the State.

Method of Sale

The Authority will periodically distribute requests for proposals or qualifications to qualified investment banking firms. Base on the submissions in response to those requests, the Authority will select a group of firms among whom the position of senior and co-senior underwriter will be rotated on the Authority's forthcoming issuances of program bonds. The Authority will reserve the discretion to select the most appropriate senior and co-senior underwriter for each issuance, and in exercising that discretion, the Authority will strive to reward the special efforts and initiative that particular firms may have shown in coming forward with innovative proposals and investing in relationships through unbilled work. The Authority will include other firms that submitted suitable responses in the underwriting groups for program bond issues. The Authority will generally sell program bonds through negotiation with the senior underwriter for a series of program bonds, and will utilize the services of its staff or financial advisor to provide assurance that the interest rates, purchase price and other terms proposed by the senior underwriter are fair and under then current market conditions and otherwise meet the Authority's criteria and objectives. Notwithstanding the foregoing, the Authority may elect to sell any particular issuance of program bonds through competitive bidding rather than through negotiation if the Authority determines that doing so would, under the circumstances, enhance the likelihood of the Authority's achieving the optimal available terms for the program bonds.

Structuring Debt

New Money

Determining the Final Maturity

New money is issued to finance capital projects. The final maturity of the debt should not exceed the estimated useful life of the assets being financed. In addition, the final maturity on the bonds should not exceed forty years from the issuance date.

Refundings

Determining the Final Maturity

Unless being done for debt restructuring purposes, the final maturity of debt issued for refunding purposes should not exceed the final maturity of the debt being refunded.

Structuring Annual Debt Service and Related Savings

In general, refunding bonds should be structured so that the annual debt service payments of the new debt will not exceed the annual debt service payments of the refunded debt in any budget year. While level savings is often the preferred method for structuring refunding bonds, other considerations, such as budgetary impact, should be considered. Structures for both realizing budgetary savings (accelerated savings) and deferred savings should be considered based on the impact on total savings and the needs of the State.

Redemption or "Call" Features

A significant tool in structuring tax-exempt bonds is the ability to make the bonds callable prior to final maturity. This provides the advantage of enabling the issuer to achieve savings through the issuance of refunding bonds in the event that interest rates decline. The standard call feature allows bonds to be called after 10 year, but prior to their maturity. Although the ability to refund bonds at that time is advantageous, there may be situations where the Authority may realize greater benefits by extending that call feature out to a period longer than 10 years.

Tax-Exempt and Taxable Debt

The State has traditionally issued tax exempt debt which results in significant interest cost savings compared with the interest cost on taxable debt. Accordingly, all State debt should be issued to take advantage of the exemption from federal income taxes unless prohibited by federal law or applicable federal regulations. In the event that taxable and tax-exempt debt is issued concurrently, the debt should be structured to maximize the interest savings associated with the tax-exempt portion.

Credit Enhancement

Purpose of Obtaining Bank Facilities and Insurance

Credit enhancement products, such as bank facilities and insurance, are used primarily to achieve interest cost savings. The purchase of credit enhancement products is permissible provided that the purchase produces net debt service savings.

Decisions to Use Bank Facilities and Insurance

The State's access to credit enhancement products is limited. At times, it may be fiscally prudent to issue debt without credit enhancement even though the use of credit enhancement would result in debt service savings. The Authority must weigh the benefits of debt service savings versus the cost of using the finite resource of credit enhancement.

Selecting a Date of Issuance

It is the policy of the Authority to try to ensure that bonds price appropriately and have sufficient investor demand. In order to best ensure consistent pricing, the Authority tries to avoid pricing bonds at times when the market may be especially volatile. As a result, the Authority monitors the calendar of major economic releases, as well as the calendar of other tax-exempt and taxable bond pricings. In general, the Authority attempts to avoid pricing during the release of major economic data or the pricing of other large or conflicting State-level bond issuances.

Use of Variable Rate Debt and Related Products

Variable Rate Products

Description of Variable Rate Bonds

As contrasted with fixed-rate bonds, bonds may also be issued with variable rates of interest. The interest rate on variable rate bonds changes periodically, e.g., daily, weekly or monthly. Bonds whose interest rate changes weekly are the most common type of variable rate debt. A significant advantage of variable rate bonds is that they typically carry an initial interest rate lower than that of a long term fixed rate bond issued at the same time. A disadvantage is that interest rates may rise and the interest rate on the variable rate bonds may increase to levels higher than the rate which could have been obtained on fixed rate bonds. Selling variable rate bonds also leads to uncertainty regarding the State's annual budget requirements for debt service and the total cost of the financing over the life of the bonds. The Authority should make adequate provisions for the financial and budgetary risks associated with variable rate debt.

Decision to Use Variable Rate Bonds

The decision to use variable rate bonds is governed by a number of considerations including the variable rate capacity of the State (including the State's cash asset position), the anticipated savings versus fixed-rate bonds, budget impact, and administrative costs. In general, the Authority should limit its unhedged variable rate exposure to no more than 30 percent of its outstanding debt. While the State can benefit from the lower initial rates when compared to fixed rate alternatives, those benefits can be negatively impacted by rising interest rates. Also, the Authority must consider the budgetary risks associated with variable rate debt, and how to budget conservatively for annual outlays for debt service. The use of interest rate caps and other debt instruments such as interest rate swaps can mitigate the budgetary impact on the State. The uses and exposure resulting from these debt instruments must be evaluated by the IFA staff and presented to the board on a semiannual basis. Lastly, the ongoing administrative costs and technical expertise to monitor and manage variable rate exposure should be considered.

Official Statement

In order to comply with all legal requirements of the Federal and State government, and to ensure that the State has disclosed all relevant information to potential investors, the State attempts to follow the disclosure recommendations of the Government Finance Officers Association, specifically the recommendation that financial statements be prepared and presented according to generally accepted accounting principles. Also, the Authority will make available the preliminary and final official statements in printed form, as well as in electronic form, and make such statements available on its internet web site.

In order to ensure that the official statement is properly updated and contains the most current information, the issuing authority should contact the appropriate State departments as soon as a decision is made to issue bonds. This will help ensure that new or updated data and forecasts are included in the official statement.

The State should print enough official statements for all interested parties, including members of the working group (including the issuing agency, underwriter, legal counsel, financial advisors, and State agencies). Because the demand for official statements can vary from issuance to issuance and the cost for printing official statements can be costly, the State should monitor demand for official statements to avoid printing an excessive number of official statements. The State should strive to utilize technology and electronic distribution of documents.

Credit Objectives, Disclosure and Legal Requirements

In order to access the credit markets at the lowest possible borrowing cost, it is recognized that credit ratings are critical. Therefore, the Authority shall strive to maintain or improve current credit ratings without adversely impacting levels of debt which may be issued for any particular program.

Continuing disclosure is necessary to ensure that investors are adequately informed on the State's credit and financial position; it is also a legal requirement of the State and the Authority. To this end, the Authority will assist all agencies of the State for which it issues bonds in complying with continuing disclosure requirements. The Authority may make available on its internet website such information as it determines to be relevant to investors.

The Authority is responsible for ensuring that all tax exempt bonds it issues remain in compliance with the federal arbitrage regulations. In carrying out these responsibilities, the Authority must monitor and analyze the investment and use of bond proceeds and calculate arbitrage rebate liabilities to protect the bonds' tax exempt status.